Risk Management Briefing

Indemnities in consultants' appointments

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Introduction

In general terms, indemnity clauses in consultants' appointments provide that the consultant will indemnify its client against certain liabilities as set out in the indemnity. The precise wording is important. The indemnity may be widely drawn to cover all losses suffered, or may be restricted to losses such as those related to death or personal injury, property damage or infringement of intellectual property rights. Typically the effect of an indemnity is to make the consultant liable for damages over and above those recoverable at common law.

Indemnity clauses are most easily recognised by the use of the term "indemnify" or "hold harmless" but these terms are not essential and other wording might disguise the effect of the clause. For example, "The Consultant shall be liable for all losses, costs, claims, actions, demands, expenses, compensation and liabilities arising out of or in connection with ..."

From the client's point of view

From the client's point of view, an indemnity appears very attractive: tightly drawn, an indemnity clause can mean that a consultant is contractually bound to recompense the client for all the losses it has suffered to a much greater extent than the damages recoverable under the common law for breach of contract.

However, the extent of the indemnity will depend upon the clarity of the wording, so the clauses need to be carefully drawn if they are to have the effect the client intends.

In addition, a client pursuing a claim against its consultant will rely on the consultant's professional indemnity (PI) insurance. This may not cover damages claimed under an indemnity; it may (possibly) be limited to negligent acts only or may expressly exclude cover

for indemnities. A typical exclusion is, "… any contractual term or agreement … in the nature of an indemnity, hold harmless warranty or guarantee".

From the consultant's point of view

The apparent advantages of an indemnity to a client represent serious risks so far as a consultant is concerned.

1. The amount payable: Unless the indemnity is drafted otherwise, the amount recoverable under it will be higher than the amount recoverable in common law for straightforward contractual damages.

An indemnity could, for example, allow a client to recover damages which would:
(i) not otherwise be recoverable because they are too remote;
(ii) otherwise be reduced by the client's duty to mitigate its loss or by reason of the client's contributory negligence;
(iii) not otherwise be recoverable because they may not have been properly or reasonably incurred;
(iv) include legal costs and expenses which would otherwise be disallowed.
If a typical wording of indemnities is used (such as "all damages, costs, losses, expenses, actions, claims and proceedings") or losses are widely defined, then all amounts suffered or incurred by the client would be payable and the usual contractual arguments relating to quantum, remoteness, duty to mitigate and reasonableness could not be used.

2. Matters giving rise to indemnity: A consultant may be liable under an indemnity even if it has not been negligent. If a client has suffered a loss for which the consultant has provided an indemnity, it merely has to show that it has suffered an indemnified loss, it need not prove that the consultant failed to exercise reasonable skill and care.

For example, an indemnity might cover "any damage to property owned by the client", meaning that the consultant would be liable even though damage to the property was inevitable when performing the services, and the consultant had not been negligent. Similarly, in the case of an indemnity against "any act or omission" leading to a loss by the client, once loss has occurred damages are recoverable – negligence is immaterial.

3. Third party claims: Indemnities are not only asked for by clients to cover their own losses, but can extend to claims brought by third parties against the client in respect of some default of the consultant (for example, claims brought by a contractor against the client because of design errors attributable to work done by the consultant). The consultant may know nothing of the claim between the contractor and client, nor be involved in any related court or arbitration proceedings, only being informed once the amount has been determined.

Settlements of third party claims by the client can also give rise to particular difficulties.

For example, a client may decide for commercial reasons to settle a claim with a third party for £500,000 when the damages properly payable by the consultant, if decided by the court, would be £350,000. There may be no opportunity (depending on the wording of the indemnity) to argue that the amount the consultant should pay should be limited to £350,000.

4. Time for claims: As well as the amount being greater, the length of time within which the client can collect the amount due under an indemnity can be much longer. The limitation

period only begins when the client suffers a loss, whereas for claims for breach of contract it begins when the contract is breached.

For example, say that in 2014 the client is sued by a third party, claiming damages resulting from the consultant's alleged negligent design undertaken in 2010, and the consultant has indemnified the client against such damages. The limitation period would be 6 (or 12 if the appointment was a deed) years from the date the 2014 litigation is concluded or settled – which could be some time hence. Contrast that with the limitation period for a breach of contract, which would be 6 (or 12) years from 2010, and would therefore expire much earlier.

5. Direct claims by third parties: If, in the contract with the client, indemnities are given to specified third parties as well as the client, those third parties may be entitled to claim under the indemnity directly as a result of the Contracts (Rights of Third Parties) Act 1999. Third parties might also be able to enforce indemnities given to the client against claims by those third parties, unless the Act is excluded.

As can be seen, there are no advantages to a consultant in giving an indemnity, and a number of serious disadvantages. It is worth noting that none of the standard forms of appointment published by the ACE or RIBA contains indemnities from the consultant, nor does the CIC Consultants' Contract.

As a general rule, consultants are advised to avoid indemnities except when it is absolutely necessary, such as for strong commercial reasons. If any indemnity is to be given, the extent and nature of the indemnity should be considered carefully. It would be sensible, for example, to limit the indemnity to the direct and foreseeable consequences of negligent acts, exclude any ex gratia element of a settlement, and include an express limitation clause, e.g. 6 or 12 years from the negligent act or from practical completion. The terms of any proposed indemnity should also be checked against the cover provided by the consultant's PI insurance policy, and legal advice may be necessary.

Possible exceptions

There are three situations when consultants might find indemnities acceptable:

1. Copyright infringement: An indemnity to a client in respect of copyright infringement by a consultant. If it is correctly worded most consultants might accept such an indemnity where it relates to the consultant's own documents and/or those of sub-consultants because the consultant should know whether it or its sub-consultants have produced the information in question. If the information may be incorporating designs, reports or information from others, then the consultant may need to exclude this from the scope of the indemnity.

2. Joint ventures: Because one of the joint venturers can become liable for acts or omissions of a co-joint venturer it is usual for cross indemnities to be given to enable an innocent joint venturer to collect any amount that it has paid from its co-joint venturer(s).

3. Indemnities from the client: Where a limitation or exclusion of liability has been agreed between a client and a consultant, this will protect the consultant when third party claims have been made against the client, but it will not protect it against third party claims made directly against the consultant. If the consultant is to be fully protected, it should not have any liability to third parties who claim directly when those claims would exceed the amount of the liability agreed with the client. This is achieved by the consultant obtaining an indemnity from the client against such claims.

However, it may well be necessary to obtain specialist legal advice in connection with each of the three situations above. In all cases the consultant should check its PII cover.

Examples to avoid

Below are examples of provisions that have been found in consultants' appointments and that have the effect of the consultant being liable for damages on an indemnity basis or for something greater than common law damages:

"Losses" may be defined widely, for example:

"In the event of a breach of this Agreement the Consultant shall be liable for all Losses", "Losses" being defined very widely as "all losses, costs, claims, demands, actions, damages, awards, liabilities, expenses, compensation, court and/or tribunal orders and all other liabilities howsoever arising (including any legal expenses) reasonably and properly incurred by a party."

Statements as to what the Consultant is liable for. In the example below the description of what the Consultant is liable for is wider than damages on the common law basis:

"Without prejudice to the rights and remedies of the parties howsoever arising, the Consultant shall be liable for all claims, costs, expenses and overheads of every kind arising out of any breach of professional duty of care by the Consultant in the performance of its obligations hereunder including, but without limitation, any indemnities in respect of any claims against the Client by the Building Contractor under the Building Contract and/or any claim by any member of the Professional Team."

In the example below the statement about the cost of carrying out work might again have the effect of imposing liability for damages over and above those recoverable at common law.

"You acknowledge that any breach of the warranty at paragraph x may cause us to be in breach of the Building Contract and/or cause us to suffer loss and/or damage. You shall be liable to us in respect of any loss, damages, proceedings and the like suffered by us arising out of such a breach, whether or not the Employer has or would have suffered a similar loss etc as a consequence of such a breach and whether or not we or you would have been liable to the Employer. Without prejudice to the generality of the foregoing, you shall also be liable to us in respect of the cost of carrying out any work arising out of or in connection with the Building Contract which was not apparent at the date of execution of the Building Contract as a consequence of your breach of paragraph x."

Statements such as the two examples below, which set out **what is reasonably foreseeable/in contemplation of the parties** are not indemnities, but in the same way could have the effect of making the consultant liable for damages on a basis other than that prescribed by the common law:

"Insofar as the Consultant's failure to comply with this Agreement results in the Contractor incurring any loss, damage, cost, expense, charges and/or liabilities under or in connection with the Building Contract, the Consultant agrees and acknowledges that such loss, damage, cost, expense, charges and/or liabilities are in the actual contemplation of the Consultant."

and

"Where the Contractor is obliged under the Construction Contract to pay compensation to the Employer under the Construction Contract in place of the carrying out of additional work or other remedial work, the Consultant shall be liable in addition to any amounts payable to the Contractor under clause [ ] above to reimburse to the Contractor a fair and reasonable proportion of such compensation."

This Risk Management Briefing is for information only, and insurance or legal advice should be taken to cover your particular circumstances.

This briefing was prepared by the CIC Liability Panel chaired by Professor Sarah Lupton

It is available at www.cic.org.uk